

Section 3. Foreign Ownership, Control, or Influence (FOCI)

2-300. General.

- a. This Section establishes the policy concerning the initial or continued clearance eligibility of U.S. companies with foreign involvement; provides criteria for determining whether U.S. companies are under foreign ownership, control or influence (FOCI); prescribes responsibilities in FOCI matters; and outlines security measures that may be considered to negate or reduce to an acceptable level FOCI-based security risks .
- b. The foreign involvement of U.S. companies cleared or under consideration for a facility security clearance (FCL) is examined to ensure appropriate resolution of matters determined to be of national security significance. The development of security measures to negate FOCI determined to be unacceptable shall be based on the concept of risk management. The determination of whether a U.S. company is under FOCI, its eligibility for an FCL, and the security measures deemed necessary to negate FOCI shall be made on a case-by-case basis.

2-301. **Policy.** Foreign investment can play an important role in maintaining the vitality of the U.S. industrial base. Therefore, it is the policy of the U.S. Government to allow foreign investment consistent with the national security interests of the United States. The following FOCI policy for U.S. companies subject to an FCL is intended to facilitate foreign investment by ensuring that foreign firms cannot undermine U.S. security and export controls to gain unauthorized access to critical technology, classified information and special classes of classified information:

- a. A U.S. company is considered under FOCI whenever a foreign interest has the power, direct or indirect, whether or not exercised, and whether or not exercisable through the ownership of the U.S. company's securities, by contractual arrangements or other means, to direct or decide matters affecting the management or operations of that company in a manner which may result in unauthorized access to classified information or may affect adversely the performance of classified contracts.
- b. A U.S. company determined to be under FOCI is ineligible for an FCL, or an existing FCL shall be suspended or revoked unless security measures are

taken as **necessary** to remove the possibility of unauthorized access or the adverse affect on classified contracts.

- c. The Federal Government reserves the right and has the obligation to impose any security method, safeguard, or restriction it believes necessary to ensure that unauthorized access to classified information is effectively precluded and that performance of classified contracts is not adversely affected.
- d. Changed ~~co~~nditions, such as a change in ownership, indebtedness, or the foreign intelligence threat, may justify certain adjustments to the security terms under which a company is operating or, alternatively, that a different FOCI negation method be employed. If a changed condition is of sufficient significance, it might also result in a determination that a company is no longer considered to be under FOCI or, conversely, that a company is no longer eligible for an FCL.
- e. Nothing contained in this Section shall affect the authority of the Head of an Agency to limit, deny or revoke access to classified information under its statutory, regulatory or contract jurisdiction. For purposes of this Section, the term "agency" has the meaning provided at 5 U.S.C. 552(f), to include the term "DoD Component."

2-302. Factors.

- a. The following factors shall be considered in the aggregate to determine whether an applicant company is under FOCI; its eligibility for an FCL; and the protective measures required:
 - (1) Foreign intelligence threat;
 - (2) Risk of unauthorized technology transfer;
 - (3) Type and sensitivity of the information requiring protection;
 - (4) Nature and extent of FOCI, to include whether a foreign person occupies a controlling or dominant minority position; source of FOCI, to include identification of immediate, intermediate and ultimate parent organizations;

- (5) Record of compliance with pertinent U.S. laws, regulations and contracts; and
- (6) Nature of bilateral and multilateral security and information exchange agreements that may pertain.

b. **In addition to** the factors shown above, the following information is required to be furnished to the CSA on the **CSA-designated** form. The information will be considered in the aggregate and the fact that some of the below listed conditions may apply does not necessarily render the applicant company ineligible for an FCL.

- (1) Ownership or beneficial ownership, direct or indirect, of 5 percent or more of the applicant company's voting securities by a foreign person;
- (2) Ownership or beneficial ownership, direct or indirect, of 25 percent or more of any class of the applicant company's non-voting securities by a foreign person;
- (3) Management positions, such as directors, officers, or executive personnel of the applicant company held by non U.S. citizens;
- (4) Foreign person power, direct or indirect, to control the election, appointment, or tenure of directors, officers, or executive personnel of the applicant company and the power to control other decisions or activities of the applicant company;
- (5) Contracts, agreements, understandings, or arrangements between the applicant company and a foreign person;
- (6) Details of loan arrangements between the applicant company and a foreign person if the applicant company's (the borrower) overall debt to equity ratio is 40:60 or greater; and details of any significant portion of the applicant company's financial obligations that are subject to the ability of a foreign person to demand repayment;
- (7) Total revenues or net income in excess of 5 percent from a single foreign person or in excess of 30 percent from foreign persons in the aggregate;

- (8) Ten percent or more of **any** class of the applicant's voting securities held in "nominee shares," in "street names," or in some other method that does not disclose the beneficial owner of equitable title;

- (9) Interlocking directors with foreign persons and any officer or management **official** of the applicant company who is also employed by a foreign person;

- (10) Any other factor that indicates or demonstrates a capability **on** the part of foreign persons to control or influence the operations or management of the applicant company; and

- (11) Ownership of 10% or more of any foreign interest.

2-303. Procedures.

a. If there are any affirmative answers on the form, or other information is received which indicates that the applicant company may be under FOCI, the CSA shall review the case to determine the relative significance of the information in regard to:

- (1) Whether the applicant is under FOCI, which shall include a review of the factors listed at 2-302;
- (2) The extent and manner to which the FOCI may result in unauthorized access to classified information or adversely impact classified contract performance; and
- (3) The type of actions, if any, that would be necessary to negate the effects of FOCI to a level deemed acceptable to the Federal Government. Disputed matters may be appealed and the applicant shall be advised of the government's appeal channels by the CSA.

b. When a company with an FCL enters into negotiations for the proposed merger, acquisition, or takeover by a foreign person, the applicant shall submit notification to the CSA of the commencement of such negotiations. The submission shall include the type of transaction under negotiation (stock purchase, asset purchase, etc.), the identity of the potential foreign person investor, and a plan to negate the FOCI by a method outlined in 2-306. **The** company

shall submit copies of loan, purchase and shareholder agreements, annual reports, bylaws, articles of incorporation, partnership agreements and reports filed with other federal agencies to the CSA.

- c. When a company with an FCL is determined to be under **FOCI**, the facility security clearance **shall** be suspended. Suspension notices shall be made as follows:

- (1) When the company has current access to classified information, the GCAS and prime contractor(s) of record shall be notified of the suspension action along with full particulars regarding the reason(s) therefor. Cognizant contracting agency security and acquisition officials shall be furnished written, concurrent notice of the suspension action. All such notices shall include a statement that the award of additional classified contracts is prohibited so long as the FCL remains in suspension.

- (2) The company subject to suspension action shall be notified that its clearance has been suspended, that current access to classified information and performance on existing classified contracts may continue unless notified by the CSA to the contrary, and that the award of new classified contracts will not be permitted until the FCL has been restored to a valid status.

- d. When necessary, the applicant company shall be advised that failure to adopt required security measures, may result in denial or revocation of the FCL. When final agreement by the parties with regard to the security measures required by the CSA is attained, the applicant **shall** be declared eligible for an FCL upon implementation of the required **security** measures. When a previously suspended FCL has been restored to a valid status, **all** recipients of previous suspension notices shall be notified.

- e. A counterintelligence threat assessment and technology transfer risk assessment shall be obtained by the CSA and considered prior to a final decision to grant an FCL to an applicant company under **FOCI** or to restore an FCL previously suspended. These assessments shall be updated periodically under circumstances and at intervals considered appropriate by the CSA.

- f. Whenever a company has been determined to be under **FOCI**, the primary consideration shall be the safeguarding of classified information. The CSA is responsible for taking whatever interim action necessary to safeguard classified information, in coordination with other affected agencies as appropriate. If the company does not have possession of classified material, and does not have a current or impending requirement for access to classified information, the FCL shall be administratively terminated.

2-304. Foreign Mergers, Acquisitions and Takeovers, and the CFIUS.

- a. Proposed merger, acquisition, or takeover (transaction) cases voluntarily filed for review by the Committee on Foreign Investment in the United States (**CFIUS**) under Section 721 of Title VII of the Defense Production Act (**DPA**) of 1950 (**P.L. 102-99**) shall be processed on a priority basis. The CSA shall determine whether the proposed transaction involves an applicant subject to this Section and convey its finding to appropriate agency authorities. If the proposed transaction would require **FOCI** negation measures to be imposed if consummated, the parties to the transaction shall be promptly advised of such measures and be requested to provide the CSA with their preliminary acceptance or rejection of them as promptly as possible.

- b. The **CFIUS** review and the industrial security review are carried out in two parallel, but separate, processes with different time constraints and considerations. Ideally, when industrial security enhancements (see Sections 2-305 and 2-306) are required to resolve industrial security concerns of a case under review by **CFIUS**, there should be agreement before a recommendation on the matter is formulated. As a technical matter, however, a security agreement cannot be signed until the proposed foreign investor legally completes the transaction, usually the date of closing. When the required security arrangement, (1) Has been rejected; or (2) When it appears agreement will not be attained regarding material terms of such an arrangement; or (3) The company has failed to comply with the reporting requirements of **this Manual**, industrial security authorities may recommend that the Department position be an investigation of the proposed transaction by **CFIUS** to assure that national security concerns are protected.

2-305. FOCI Negation Action Plans. If it is determined that an applicant company may be ineligible for an FCL or that additional action would be **necessary** to negate the FOCI, the applicant shall be promptly advised and requested to submit a negation plan.

- a. In those cases where the FOCI stems from foreign ownership, a plan shall consist of one of the methods prescribed at 2-306. Amendments to purchase and shareholder agreements may also serve to remove FOCI concerns.
- b. When factors not related to ownership are present, the **plan shall** provide positive measures that assure that the foreign person can be effectively denied access to classified information and cannot otherwise adversely affect performance on classified contracts. Examples of such measures include: modification or termination of loan agreements, contracts and other understandings with foreign interests; diversification or reduction of foreign source income; demonstration of financial viability independent of foreign persons; elimination or resolution of problem debt; assignment of specific oversight duties and responsibilities to board members; formulation of special executive-level security committees to consider and oversee matters that impact upon the performance of classified contracts; physical or organizational separation of the facility component performing on classified contracts; the appointment of a technology control officer; adoption of special board resolutions; and other actions that negate foreign control or influence.

2-306. Methods to Negate Risk in Foreign Ownership Cases. Under normal circumstances, foreign ownership of a U.S. company under consideration for an FCL becomes a concern to the U.S. Government when a foreign shareholder has the ability, either directly or **indirectly**, whether exercised or exercisable, to control or influence the election or appointment of one or more members to the applicant company's board of directors by any means (equivalent equity for unincorporated companies). Foreign ownership which cannot be so manifested is not, in and of itself, considered significant.

- a. **Board Resolution.** When a foreign person does not own voting stock sufficient to elect, or otherwise is not entitled to representation to the applicant company's board of directors, a resolution(s) by the applicant's board of directors will normally be adequate. The Board shall identify the foreign shareholder and describe the type and number of foreign

owned shares; acknowledge the applicant's obligation to comply with all industrial security program and export control requirements; certify that the foreign shareholder shall not require, shall not have, and can be effectively precluded from unauthorized access to all classified and export-controlled information entrusted to or held by the applicant company; will not be permitted to hold positions that may enable them to influence the performance of classified contracts; and provide for an annual certification to the CSA acknowledging the continued effectiveness of the resolution. The company shall be required to distribute to members of its board of directors and its principal officers copies of such resolutions and report in the company's corporate records the completion of such distribution.

- b. **Voting Trust Agreement and Proxy Agreement.** The Voting Trust Agreement and the Proxy Agreement are **substantially** identical arrangements whereby the voting rights of the foreign owned stock are vested in cleared U.S. citizens approved by the Federal Government. Neither arrangement imposes any restrictions on a company's eligibility to have access to classified information or to compete for classified contracts.

- (1) Establishment of a Voting Trust or Proxy Agreement involves the selection of three trustees or proxy holders respectively, all of whom must become directors of the cleared company's board. Both arrangements must provide for the exercise of all prerogatives of ownership by the voting trustees or proxy holders with complete freedom to act **independently** from the foreign person stockholders. The arrangements may, however, limit the authority of the trustees or proxy holders by requiring that approval be obtained from the foreign person stockholder(s) with respect to matters such as: (a) The sale or disposal of the corporation's assets or a substantial part **thereof**; (b) Pledges, mortgages, or other encumbrances on the capital stock; (c) Corporate mergers, consolidations, or reorganizations; (d) The dissolution of the corporation; and (e) The filing of a bankruptcy petition. However, nothing herein prohibits the trustees or proxy holders from consulting with the foreign person stockholders, or vice versa, where otherwise consistent with U.S. laws, regulations and the terms of the Voting Trust or Proxy Agreement.

(2) The voting trustees or proxy holders must assume full responsibility for the voting stock and for exercising all management prerogatives relating thereto in such a way as to ensure that the foreign stockholders, except for the approvals enumerated in (1) above, shall be insulated from the cleared company and continue solely in the status of beneficiaries. The company shall be organized, structured, and financed so as to be capable of operating as a viable business entity independent from the foreign stockholders.'

(3) Individuals who serve as voting trustees or proxy holders must be: (a) U.S. citizens residing within the United States, who are capable of assuming full responsibility for voting the stock and exercising management prerogatives relating thereto in a way that ensures that the foreign person stockholders can be effectively insulated from the cleared company; (b) Completely disinterested individuals with no prior involvement with the applicant company, the corporate body with which it is affiliated, or the foreign person owner; and (c) Eligible for a PCL at the level of the FCL.

(4) Management positions requiring personnel security clearances in conjunction with the FCL must be filled by U.S. citizens residing in the United States.

c. Special Security Agreement and Security Control Agreement. The Special Security Agreement (SSA) and the Security Control Agreement (SCA) are substantially identical arrangements that impose substantial industrial security and export control measures within an institutionalized set of corporate practices and procedures; require active involvement of senior management and certain Board members in security matters (who must be cleared, U.S. citizens); provide for the establishment of a Government Security Committee (GSC) to oversee classified and export control matters; and preserve the foreign person shareholder's right to be represented on the Board with a direct voice in the business management of the company while denying unauthorized access to classified information.

(1) A company effectively owned or controlled by a foreign person may be cleared under the SSA arrangement. However, access to "proscribed information" is permitted only with the written permission of the cognizant U.S.

agency with jurisdiction over the information involved. A determination to disclose proscribed information to a company cleared under an SSA requires that a favorable National Interest Determination (see 2-309) be rendered prior to contract award. Additionally, the Federal Government must have entered into a General Security Agreement with the foreign government involved.

(2) A company not effectively owned or controlled by a foreign person may be cleared under the SCA arrangement. Limitations on access to classified information are not required under an SCA.

d. Limited Facility Clearance. The Federal Government has entered into Industrial Security Agreements with certain foreign governments. These agreements establish arrangements whereby a foreign-owned U.S. company may be considered eligible for an FCL. Access limitations are inherent with the granting of limited FCLs.

(1) A limited FCL may be granted upon satisfaction of the following criteria: (a) There is an Industrial Security Agreement with the foreign government of the country from which the foreign ownership is derived; (b) Access to classified information will be limited to performance on a contract, subcontractor program involving the government of the country from which foreign ownership is derived; and (c) Release of classified information must be in conformity with the U.S. National Disclosure Policy,

(2) A limited FCL may also be granted when the criteria listed in paragraph (1) above cannot be satisfied, provided there exists a compelling need to do so consistent with national security interests.

2-307. Annual Review and Certification.

a. Annual Review. Representatives of the CSA shall meet at least annually with senior management officials of companies operating under a Voting Trust, Proxy Agreement, SSA, or SCA to review the purpose and effectiveness of the clearance arrangement and to establish common understanding of the operating requirements and their implementation. These reviews will also include an examination of the following:

- (1) Acts of compliance or noncompliance with the approved security arrangement, standard rules, and applicable laws and regulations.
- (2) Problems or impediments associated with the practical application or utility of the security arrangement.
- (3) Whether security controls, practices, or procedures warrant adjustment.

b. **Annual Certification.** Depending upon the security arrangement in place, the Voting trustees, Proxy holders or the Chairman of the GSC shall submit annually to the CSA an implementation and compliance report. Such reports shall include the following:

- (1) A detailed description of the manner in which the company is carrying out its obligations under the arrangement.
- (2) Changes to security procedures, implemented or proposed, and the reasons for those changes.
- (3) A detailed description of any acts of noncompliance, whether inadvertent or intentional, with a discussion of steps that were taken to prevent such acts from recurring.
- (4) Any changes, or impending changes, of senior management officials, or key Board members, including the reasons therefor.
- (5) Any changes or impending changes in the organizational structure or ownership, including any acquisitions, mergers or divestitures.
- (6) Any other issues that could have a bearing on the effectiveness of the applicable security clearance arrangement.

2-308. **Government Security Committee (GSC).**

Under a Voting Trust, Proxy Agreement, SSA and SCA, an applicant company is required to establish a permanent committee of it's Board of Directors, known as the GSC.

- a. The GSC normally consists of Voting Trustees, Proxy Holders or Outside Directors, as applicable, and those officers/directors who hold PCLS.

- b. The members of the GSC are required to ensure that the company maintains policies and procedures to safeguard export controlled and classified information entrusted to it.
- c. The GSC shall also take the necessary steps to ensure that the company complies with U.S. export control laws and regulations and does not take action deemed adverse to performance on classified contracts. This shall include the appointment of a Technology Control Officer (TCO) and the development, approval, and implementation of a Technology Control Plan (TCP).
- d. The Facility Security Officer (FSO) shall be the principal advisor to the GSC and attend GSC meetings. The Chairman of the GSC, must concur with the appointment of replacement FSOS selected by management. FSO and TCO functions shall be carried out under the authority of the GSC.

2-309. **National Interest Determination.**

- a. A company cleared under an SSA and its cleared employees may only be afforded access to "proscribed information" with special authorization. This special authorization must be manifested by a favorable national interest determination (NID) that must be program/project/contract-specific. Access to proscribed information must be predicated on compelling evidence that release of such information to a company cleared under the SSA arrangement advances the national security interests of the United States. The authority to make this determination shall not be permitted below the Assistant Secretary or comparable level of the agency concerned.
- b. A proposed NID will be prepared and sponsored by the GCA whose contractor program, is involved and it shall include the following information:
 - (1) Identification of the proposed **awardee** along with a synopsis of its foreign ownership (include solicitation and other reference numbers to identify the action);
 - (2) General description of the procurement and performance requirements;
 - (3) Identification of national security interests involved and the ways in which award of the contract helps advance those interests;

- (4) The availability of any other U.S. company with the capacity, capability, and technical expertise to satisfy acquisition, technology base, or industrial base requirements and the reasons any such company should be denied the contract; and
 - (5) A description of any alternate means available to satisfy the requirement, and the reasons alternative means are not acceptable.
- c. An **NID** shall be initiated by the GCA. A company may assist in the preparation of an NID, but the GCA is not obligated to pursue the matter further unless it believes further consideration to be warranted. The GCA shall, if it is supportive of the NID, forward the case through appropriate agency channels to the ultimate approval authority within that agency. If the proscribed information is under the classification or control jurisdiction of another agency, the approval of the cognizant agency is required; e.g., NSA for **COMSEC**, DCI for **SCI**, DOE for **RD** and **FRD**, the Military Departments for their **TOP SECRET** information, and other Executive Branch Departments and Agencies for classified information under their cognizance.
- d. It is the responsibility of the cognizant approval authority to ensure that pertinent security, **counterintelligence**, and acquisition interests are thoroughly examined. Agency-specific case processing details

and the senior official(s) responsible for rendering final approval of NID's shall be contained in the implementing regulations of the U.S. agency whose contract is involved.

2-310. Technology Control Plan. A TCP approved by the CSA shall be developed and implemented by those companies cleared under a Voting Trust Agreement, Proxy Agreement, SSA and SCA and when otherwise deemed appropriate by the CSA. The TCP shall prescribe all security measures determined necessary to reasonably foreclose the possibility of inadvertent access by **non-U.S.** citizen employees and visitors to information for which they are not authorized. The TCP shall also prescribe measures designed to assure that access by **non-U.S.** citizens is strictly limited to only that specific information for which appropriate Federal Government disclosure authorization has been obtained; e.g., an approved export license or technical assistance agreement. Unique badging, escort, segregated work area, security indoctrination schemes, and other measures shall be included, as appropriate.

2-311. Compliance. Failure on the part of the company to ensure compliance with the terms of any approved security arrangement may constitute grounds for revocation of the company's FCL.